APPENDIX A

MESSAGE OF GOVERNOR HUGHES

STATE OF NEW YORK
EXECUTIVE CHAMBER,
ALBANY

January 5, 1910

To the Legislature:

I have received from the Secretary of State of the United States a certified copy of a resolution of Congress entitled "Joint Resolution Proposing an Amendment to the Constitution of the United States," and in accordance with his request I submit it to your honorable body for such action as may be had thereon.

The amendment proposed by this joint resolution, adopted by two-thirds of both houses of Congress, is as follows:

> "Article XVI. The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

The power to lay a tax upon incomes, without apportionment, was long supposed to be possessed by the Federal government and has been repeatedly exercised. Such taxes were laid and paid for the purpose of meeting the exigencies caused by the Civil War.

In 1895, in the case of Pollock v. Farmers' Loan & Trust Company (158 U.S. 601), the United States Supreme Court decided that taxes on the rents or income of real estate, and taxes on personal property or on the income of personal property, are direct taxes and hence under the Constitution cannot be imposed without apportionment among the several States according to their respective populations.

It was not the function of the court, and it did not attempt, to decide whether or not a Federal income tax

was desirable. It simply interpreted the Constitution according to the judgment of the majority of its members and left the question of the advisability of conferring such a power upon the Federal government to be determined in the constitutional method.

The limitations so placed upon the Federal taxing power are thus described by Mr. Justice Harlan in his dissenting opinion:

> "Any attempt upon the part of Congress to apportion among the States, upon the basis simply of their population, taxation of personal property or of incomes, would tend to arouse such indignation among the freemen of America that it would never be repeated. When, therefore, this court adjudges, as it does now adjudge, that Congress cannot impose a duty or tax upon personal property, or upon income arising either from rents of real estate or from personal property, including invested personal property, bonds, stock and investments of all kinds, except by apportioning the sum to be so raised among the States according to population, it practically decides that, without an amendment of the Constitution—two-thirds of both Houses of Congress and three-fourths of the States concurring—such property and incomes can never be made to contribute to the support of the national government. (Id., pp. 671, 2)
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> "Incomes arising from trades, employment, callings, and professions can be taxed, under the rule of uniformity or equality, by both the national government and the respective State governments, while incomes from property, bonds, stocks, and investments cannot, under the present decision, be taxed by the national government except under the impracticable rule of apportionment among the States according to population. No sound reason for such a discrimination has been or can be suggested." (Id., p. 680.)

I am in favor of conferring upon the Federal government the power to lay and collect an income tax without apportionment among the States according to population. I believe that this power should be held by the Federal government so as properly to equip it with the means of meeting national exigencies.

But the power to tax income should not be granted in such terms as to subject to Federal taxation the incomes derived from bonds issued by the State itself, or those issued by municipal governments organized under the State's authority. To place the borrowing capacity of the State and of its governmental agencies at the mercy of the Federal taxing power would be an impairment of the essential rights of the State which, as its officers, we are bound to defend.

You are called upon to deal with a specific proposal to amend the Constitution, and your action must necessarily be determined not by a general consideration of the propriety of a just Federal income tax, but whether or not the particular proposal is of such a character as to warrant your assent.

This proposal is that the Federal Government shall have the power to lay and collect taxes on incomes "from whatever source derived."

It is to be borne in mind that this is not a mere statute to be construed in the light of constitutional restrictions, express or implied, but a proposed amendment to the Constitution itself which, if ratified, will be in effect a grant to the Federal government of the power which it defines.

The comprehensive words, "from whatever source derived," if taken in their natural sense, would include not incomes from ordinary real or personal property, but also incomes derived from State and municipal securities.

It may be urged that the amendment would be limited by construction. But there can be no satisfactory assurance of this. The words in terms are all-inclusive. An

amendment to the Constitution of the United States is the most important of political acts, and there would be no amendment expressed in such terms as to afford the opportunity for Federal action in violation of the fundamental conditions of State authority.

I am not now referring to the advantage which the State might derive from the exclusive power to tax incomes from property, or to the argument that for this reason the power to tax such incomes should be withheld from the Federal government. To that argument I do not assent.

I am referring to a proposal to authorize a tax which might be laid in fact upon the instrumentalities of State government. In order that a market may be provided for State bonds, and for municipal bonds, and that thus means may be afforded for State and local administration, such securities from time to time are excepted from taxation. In this way lower rates of interest are paid then otherwise would be possible. To permit such securities to be the subject of Federal taxation is to place such limitations upon the borrowing power of the State as to make the performance of the functions of local government a matter of Federal grace.

This has been repeatedly recognized. In the case of The Collector v. Day (11 Wall. on p. 127), decided in 1870, the United States Supreme Court said:

> "It is admitted that there is no express provision in the Constitution that prohibits the general government from taxing the means and instrumentalities of the States, nor is there any prohibiting the States from taxing the means and instrumentalities of that government. In both cases the exemption rests upon necessary implications, and is upheld by the great law of self-preservation; as any government, whose means employed in conducting its operations, if subject to the control of another and distinct government, can exist only at the mercy of that govern-

ment. Of what avail are these means if another power may tax them at discretion?"

In the case of Pollock v. Farmers' Loan & Trust Co. (157 U.S. on pp. 584-5), Chief Justice Fuller said, referring to the tax upon incomes from muncipal bonds, one of the matters there involved:

> "A municipal corporation is the representative of the State and one of the instrumentalities of the State government. It was long ago determined that the property and revenues of municipal corporations are not subjects of Federal taxation. * * * But we think the same want of power to tax the property or revenues of the States or their instrumentalities exists in relation to a tax on the income from their securities."

In the same case Mr. Justice Field said (Id. on p. 601):

> "These bonds and securities are as important to the performance of the duties of the State as like bonds and securities of the United States are important to the performance of their duties, and are as exempt from the taxation of the United States as the former are exempt from the taxation of the States."

And the learned Justice added, quoting from United States *v.* Railroad Co. (17 Wall. on pp. 322, 327) as follows:

> "The right of the States to administer their own affairs through their legislative, executive, and judicial departments, in their own manner through their own agencies, is conceded by the uniform decisions of this court, and by the practice of the Federal government from its organization. This carries with it an exemption of those agencies and instruments from the taxing power of the Federal government. If they may be taxed lightly, they may be taxed

> heavily; if justly, oppressively. Their operation may be impeded and may be destroyed, if any interference is permitted. Hence, the beginning of such taxation is not allowed on the one side, is not claimed on the other."

While the justices of the court in the Pollock cases differed in opinion upon the question whether a tax upon income from property was a direct tax and as such could not be laid without apportionment, they were unanimous in their conclusion that no Federal tax could be laid upon the income from municipal bonds. Mr. Justice White, who dissented in the Pollock case with regard to other questions, as to this said (157 U.S. on p. 652):

> "The authorities cited in the opinion are decisive of this question. They are relevant to one case and not to the other, because, in the one case, there is full power in the Federal government to tax, the only controversy being whether the tax imposed is direct or indirect; while in the other there is no power whatever in the Federal government, and, therefore, the levy, whether direct or indirect, is beyond this taxing power."

It is certainly significant that the words, "from whatever source derived," have been introduced into the proposed amendment as if it were the intention to make it impossible for the claim to be urged that the income from any property, even though it consist of the bonds of the State or of a municipality organized by it, will be removed from the reach of the taxing power of the Federal government.

The immunity from Federal taxation that the State and its instrumentalities of government now enjoy is derived not from any express provision of the Federal Constitution, but from what has been deemed to be necessary implication. Who can say that any such implication with respect to the proposed tax will survive the adoption of this explicit and comprehensive amendment?

We cannot suppose that Congress will not seek to tax incomes derived from securities issued by the State and its municipalities. It has repeatedly endeavored to lay such taxes and its efforts have been defeated only by implied constitutional restriction which this amendment threatens to destroy. While we may desire that the Federal government may be equipped with all necessary national powers in order that it may perform its national function, we must be equally solicitous to secure the essential bases of State government.

I therefore deem it my duty, as Governor of the State, to recommend that this proposed amendment should not be ratified.

CHARLES E. HUGHES

New York State Senate Journal, 133rd. Session, Vol. 2, Executive Journal, pp. 54-60.

APPENDIX B

LETTER TO SENATOR ROOT

Washington, D.C.
February 17, 1910

MY DEAR SENATOR:

Since our conversation last month I have given much consideration to the scope and effect of the proposed income tax amendment to the Constitution of the United States.

Much as I respect the opinion of the governor of the State, I can not agree with the view expressed in his special message of January 5, and as I advocated in the Senate the resolution to submit the proposed amendment, it seems appropriate that I should state my view of its effect.

The proposed amendment is in these words:

"ART. 16. The Congress shall have the power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States and without regard to any census or enumeration."

The objection made to the amendment is that this will confer upon the National Government the power to tax incomes derived from bonds issued by the States or under the Authority of the States, and will place the borrowing capacity of the State and its governmental agencies at the mercy of the Federal taxing power.

I do not find in the amendment any such meaning or effect, I do not consider that the amendment in any degree whatever will enlarge the taxing power of the National Government or will have any effect except to relieve the exercise of that taxing power from the requirement that the tax shall be apportioned among the several States. The effect of the amendment will be in my view,

the same as if said, "The United States may lay a tax on incomes without apportioning the tax, and this shall be applicable whatever the source of the income subjected to the tax," leaving the question, "What incomes are subject to national taxation?" to be determined by the same principles and rules which are now applicable to the determination of that question.

If we were to construe the proposed amendment only by a critical examination of its words, the view upon which the objection is based would be reached by practically cutting the provision in two and reading it as if it read, "the Congress shall have the power to lay and collect taxes on incomes from whatever source derived," without the concluding words. But we are not at liberty to do this. The amendment consists of a single sentence and the whole of it must be read together. It expresses but a single idea, and that is that the tax to which it relates must be laid and collected without apportionment among the several States and without regard to any census or enumeration, while the words "from whatever source derived" are obviously introduced to make the exemption from the rule of apportionment comprehensive and applicable to all taxes on incomes.

We are not left, however, to a mere critical examination of words. This provision, as Mr. Justice Bradley said of the Constitution in the Legal tender cases, is "to be interpreted in the light of history and of the circumstances of the period in which it was framed." Justice Story said of another clause of the Constitution, in Brisco v. The Bank of Kentucky (2 Peters, 332).

> "And I mean to insist that the history of the colonies before and during the Revolution and down to the very time of the adoption of the Constitution constitutes the highest and most authentic evidence to which we can resort to interpret this clause of the instrument, and to disregard it would be to blind ourselves to the practical mischiefs which it was

meant to suppress and to forget all the great purposes to which it was to be applied."

This view must necessarily be applied to the proposed amendment if it be adopted. It will be construed in the light of the judicial and political history which led to the proposal and which appears upon the public records of our Government.

What is that history? The Constitution of 1787 conferred upon the National Government the power of taxation without any limit whatever, except that taxes on exports were prohibited.

The method of exercising the power, however, was subjected to two limitations. One, that imposts, duties, and excises should be uniform, and the other that direct taxes should be apportioned among the States. The apportionment provisions were as follows:

"ARTICLE I.

"SEC. 2. Representatives and direct taxes shall be apportioned among the several States which may be included within this Union according to their respective numbers," etc. (Amended, but not in this respect, by the fourteenth amendment.)

"SEC. 9. No capitation or other direct tax shall be laid unless in proportion to the census or enumeration before directed to be taken."

For more than a hundred years after the adoption of the Constitution various tax laws of Congress were from time to time brought before the courts upon objections that they imposed direct taxes in violation of the rule of apportionment. The decisions of the courts uniformly sustained these laws, from the Hylton case, in 1796, which sustained an unapportioned tax on carriages (3 Dallas, 171), to the Springer case, in 1880, which sustained an unapportioned tax on incomes. (102 U.S., 586.)

In the meantime numerous laws were passed and enforced imposing taxes on incomes without apportionment,

and a great part of the means for carrying on the Civil War was derived from such taxes.

In the year 1895, however, an income tax law included in the Wilson tariff act of 1894 was brought before the Supreme Court in the case of Pollock against the Farmers' Loan & Trust Co., and in that case the court decided against the law. The case was heard twice. On the first hearing a majority of the court held that a tax on income derived from real estate must be apportioned as a direct tax, because a tax on real estate itself would be direct, and the judges divided equally as to whether a tax on income derived from personal property must be apportioned. (157 U.S., 429.)

Upon the second hearing of the case the court, by a majority of five to four, held that a tax upon income derived from personal property must be considered a direct tax and must be apportioned (158 U.S., 601). All the judges agreed, however, that taxes on incomes derived from business or occupations need not be apportioned. The effect of these decisions was thus described in one of the minority opinions:

> "But the serious aspect of the present decision is that by a new interpretation of the Constitution it so ties the hands of the legislative branch of the Government that without an amendment of that instrument, or unless this court at some future time should return to the old theory of the Constitution, Congress can not subject to taxation—however great the needs or pressing the necessities of the Government—either the invested personal property of the country, bonds, stocks, and investments of all kinds, or the income arising from the renting of real estate or from the yield of personal property, except by the grossly unequal and unjust rule of apportionment among the States. Thus, undue and disproportioned burdens are placed upon the many, while the few, safely entrenched behind the rule of apportionment

> among the States on the basis of numbers, are permitted to evade their share of responsibility for the support of the Government ordained for the protection of the rights of all."

It was so evidently impossible to collect an income tax apportionment among the States according to population that the general judgment of the country confirmed the opinion that the decision in the Pollock case had practically taken away from the Congress a power of vital importance to the General Government—a power the exercise of which had, at least in one time of peril, proved essential to the Nation's life.

The attention of the country was sharply called to the need of more Government revenue for the first time after the Pollock case by the decrease of customs and internal revenue receipts and the rapidly mounting deficit which followed the financial panic of 1907; and in the extraordinary session of Congress which began March 15, 1909, when the revised tariff bill came into the Senate, an amendment to the bill was introduced reproducing in substance the old income tax provisions of 1894 which the Supreme Court had held to be invalid both as to income derived from real estate and as to income derived from personal property. The avowed and necessary effect of including such provisions in the new tariff law would be to present again to the Supreme Court the same questions which had been decided in the Pollock case and to challenge a reversal of their decision. Thereupon the resolution for the submission of this amendment was introduced in the Senate and was passed by Congress.

The proposal followed the suggestions of the Supreme Court in the Pollock case.

The evil to be remedied was avowedly and manifestly the incapacity of the National Government resulting from the decision that income practically could not be taxed when derived either from real estate or from personal

property, although it could be taxed when derived from business or occupation.

The terms of the amendment are apt to cure that evil and to take away from the different classes of income considered by the court a practical immunity from taxation based upon the source from which they were derived.

There was no question in Congress or in the courts or in the country about the taxation of State securities. No one claimed that the inability of the General Government to tax them was an evil. The inability to tax them did not arise from the terms of the Constitution, but from the fact that, being the necessary instruments of carrying on other and sovereign governments, they were not the proper subject of national taxation, and that, therefore, no provisions of the Constitution, however wide the scope of their language, could be held to apply to such securities or to the income from them. Judge Cooley, in his work on Constitutional Law, says:

> "The power to tax, whether by the United States or by the States, is to be construed in the light of, and limited by, the fact that the States and the Union are inseparable, and that the Construction contemplates the perpetual maintenance of each with all its constitutional powers, unembarrassed and unimpaired by any action of the other. The taxing power of the Federal Government does not therefore extend to the means or agencies through or by the employment of which the States perform their essential functions, etc."

This rule of construction has been maintained for generations. It is undisputed; it was referred to with approval by the justices who wrote and delivered the opinions in the Pollock case both for and against the judgment. It has been declared again and again by the Supreme Court to be not open to question. It is a rule of construction just as controlling in defining the scope of the proposed amendment as it is in defining the scope

of the existing provisions. Under it, from the earliest times of our Government, the apparently unlimited taxing power conferred by the terms of the Constitution has been held not to apply to the instrumentalities of the State. Under it acts of Congress which by their express terms appeared to include instrumentalities of State government have uniformly been held not to include them; this uniform, long-established, and indisputable rule applied to the construction of our Constitution—a rule which has been declared to be essential to a continuance of our dual system of government—forbids that the words of that instrument conferring the power of taxation shall be deemed to apply to anything but the proper subjects of national taxation. Under it we are forbidden to apply the words "from whatever source derived" in the proposed amendment to any of the instrumentalities of State government.

This amendment will be no new grant of power. The Congress already has power to impose taxes on incomes from whatever source derived subject to the rule of construction which excludes State securities from the operation of the power, but the taxes so imposed must be apportioned among the States. Under the proposed amendment there will be the same and no greater power to tax incomes, from whatever source derived, subject to the same rule of construction, but relieved from the requirement that the tax shall be apportioned.

It appears, therefore, that no danger to the powers or instrumentalities of the States is to be apprehended from the adoption of the amendment.

It would be cause for regret if the amendment were rejected by the Legislature of New York.

It is said that a very large part of any income tax under the amendment would be paid by citizens of New York. That is undoubtedly true, but there is all the more reason why our legislature should take special care to exclude every narrow and selfish motive from influence

upon its action and should consider the proposal in a spirit of broad patriotism and should act upon it for the best interests of the whole country.

The main reason why the citizens of New York will pay so large a part of the tax is that New York City is the chief financial and commercial center of a great country with vast resources and industrial activity. For many years Americans engaged in developing the wealth of all parts of the country have been going to New York to secure capital and market their securities and to buy their supplies. Thousands of men who have amassed fortunes in all sorts of enterprises in other States have gone to New York to live, because they like the life of the city or because their distant enterprises require representation at the financial center. The incomes of New York are in a great measure derived from the country at large. A continual stream of wealth sets toward the great city from the mines and manufactories and railroads outside of New York. The United States is no longer a mere group of separate communities embraced in a political union; it has became a product of organic growth, a vast industrial organization covering and including the whole country; and the relation of New York City to the whole organization of which it is a part is the great source of her wealth and the chief reason why her citizens will pay so great a part of an income tax. We have the wealth because behind the city stands the country. We ought to be willing to share the burdens of the National Government in the same proportion in which we share benefits.

The circumstances that originally justified the establishment of the rule of apportionment in the Constitution have long since passed away. It is universally conceded that its application to existing conditions would be so unjust and inequitable as to be impossible. The power of taxation which the rule makes it impossible for the Nation to exercise may be again, as it has once been, vital to the preservation of national existence. It would be

most unfortunate if the several States of the Union were to insist upon the continuance of this unjust and useless limitation upon the necessary powers originally and wisely granted to the National Government.

With kind regards, I am always

Faithfully yours,

ELIHU ROOT

To: Hon. Frederick M. Davenport,
Senate Chamber, Albany, N.Y.

On February 15, 1910, a resolution had been introduced in the New York State Senate requesting that Senator Root be invited to address the State Legislature on the proposed amendment, *New York State Senate Journal*, 133rd Session, 1910, vol. 1, p. 147. Senator Davenport presented the above letter to the Senate on February 28, 1910 and copies were ordered printed and referred to the Committee on the Judiciary. Id. at 236.

APPENDIX C

REPORT OF SENATOR AUSTIN

During the September 19, 1940 discussion with Senator Brown, Senator Austin requested permission to insert the following matter in the Record, 86 Cong. Rec. 12294. It appears at pages 12297-12298.

Governor Plaisted said:

"In approving the proposed amendment we are not conferring any new right on the Nation, nor are we taking any right now reserved to the State."

Governor Hadley said:

"I do not believe that objection therein urged is likely to arise as a result of this power by the National Congress if conferred, and, if it should arise, it is my opinion that under the decisions of the Supreme Court of the United States, it is not well founded in law. And this is the position that has been taken by some of the most prominent representatives in the National Congress in the discussions of this question."

Governor Fort said:

"Nor am I inclined to accept the statement that the Supreme Court * * * might construe the words 'from whatever source derived' * * * as justifying the taxing of the securities of any other power."

* * * * *

"I think the principle thus quoted, which is founded upon public policy, would obtain, in construing a constitutional provision, equally as firmly as in the construction of an act of Congress."

Governor Noel said:

"I do not concur in either the view or the recommendation of Governor Hughes in opposition to the income-tax amendment. I do not believe the courts would hold that

authority to tax incomes would authorize any action that would impair any instrumentality of the State or municipal governments."

Governor Harmon said:

"I have recommended ratification of the income-tax amendment. Comity between kindred sovereignties should require the amendment to be taken as applying to incomes from private sources only * * *."

Still other Governors showed doubts as to Governor Hughes' view. Thus, for example, Governor Baldwin, of Connecticut, said:

"It is unfortunate that the wording of the proposed amendment is such as to raise upon its face a doubt as to its meaning in respect to a material point. In the view of some lawyers, it would authorize Congress to tax holders of State securities * * *. In the view of other lawyers, the amendment would not affect the existing rule * * *."

Governor Marshall, of Indiana, said:

"* * * It may be conferring upon the General Government a larger power in the nature of taxation than the States have ever intended to confer, * * *."

Governor Norris, of Montana, said:

"Some objections have been made to the adoption of the amendment on the ground that the words 'from whatever source derived' permit the levy of a tax on incomes received from State * * * indebtedness * * *."

Governor Burke, of North Dakota, said:

"Some of the ablest lawyers in the land object to the broad terms in which the language giving the power to tax is couched. * * * While on the other hand just as able lawyers insist that the Constitution contemplates the independent exercise by the Nation and the States of their constitutional powers and the obligations of the State cannot be impaired by this grant of power."

To sum up, the situation with respect to the ratifying States was this: Mr. Hughes, as Governor of the State of New York, voiced fears that the proposed amendment might be interpreted as possibly opening the door to the taxation of the income from State and municipal bonds. This view, however, was officially controverted by Senators Borah, Root, and Brown. Of these three, Senator Borah was the leading spirit behind the amendment. Senator Brown officially introduced it and Senator Root was credited, by at least one authority, with being the actual author of the amendment; and, moreover, he was one of Governor Hughes' two representatives in the Senate. Following their respective interpretations, no one in the Senate or House rose to challenge their views. John Phillip Wenchel, chief counsel, Bureau of Internal Revenue, has inadvertently created the impression that the opposition to the Borah-Root-Brown views was voiced on the floor of the Senate. Thus, in the paper entitled "Legal Discussion," which he filed before the Senate Committee on Intergovernmental Taxation, he quoted language from Senator Edmunds, of Vermont, which would indicate that the latter gentleman disagreed with or challenged the Borah-Root-Brown views on the floor of the Senate. What happened is this: Former Senator Edmunds, of Vermont, addressed a letter to a then Senator. In this letter the former Vermont Senator strongly condemned the possible taxation of State and munincipal securities, as well as the whole theory of the income tax. The latter was printed in the RECORD, without discussion. Thus the States can reassert the proposition that the Borah-Root-Brown views of the amendment were not challenged in the Senate or House.

The Department of Justice erroneously and fallaciously concludes that when the States ratified the amendment without referring to either of two diverse schools of thought, the States must have accepted the view most favorable to the contentions urged by the Department of Justice. This is, of course, absurd on its face. And moreover if silence may be regarded as acquiescence (in some

circumstances) it is absurd to argue that in this case it amounted to an acceptance of Governor Hughes' fears. If silence gives rise to acquiescence, surely it is acquiescence in the latest views expressed in a controversy. After Governor Hughes voiced his fears, others said they were groundless and unjustified under the language and intent of the amendment. The States submit, therefore, that it cannot be argued with force that because of a State's omission to challenge Governor Hughes' fears, it acquiesced in the surrender of its sovereignty.

It is, of course, absurd to suppose that the States intended—in ratifying the sixteenth amendment—to give up their immunity from tax by the Federal Government without the Federal Government in turn giving up its immunity. It is ridiculous to suppose that the States would have intended to ratify the amendment under such circumstances.

The record fails to support any conclusion that the amendment was ratified by the States in acceptance of the view that it was intended to vest Congress with the power to tax State and municipal bonds.

APPENDIX D

REMARKS OF REPRESENTATIVE CORDELL HULL

The following exchange accompanied introduction of the Tariff-Income Tax Bill, H.R. 3321, 93rd Cong., 1st Sess. (1913):

> Mr. HULL: . . . Paragraph C exempts from the law salaries of State and local officers and interest upon State and local bonds. The Supreme Court has often held that under our form of government the States have no power to tax the instrumentalities of the Federal Government, and conversely that the Federal Government has no power under the Constitution to tax the instrumentalities of the States; not desiring to raise any constitutional question, or to arouse the antagonism of any of the States, this provision was inserted.
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> Mr. BARTLETT: May I interrupt the gentlemen?
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> Mr. HULL: Certainly.
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> Mr. BARTLETT: It is a fact that in my State and in a number of other States, when this amendment was up before the legislature for adoption, many people opposed the adoption of the amendment because there was nothing specifically said in the amendment that excepted State, municipal, and other subdivisions of State bonds from taxation under the proposed amendment: but the friends of the amendment felt justified in assuring them that except in great stress, except in time of war, Congress would never think it wise to tax the bonds of the State or the subdivisions thereof.
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> Mr. HULL: Mr. Chairman, I think the suggestion of the gentleman is entirely pertinent.
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> MR. BARTLETT: In other words, the people were assured by the friends of this measure that it would be only in rare cases that Congress would ever be

called upon to enact any law which would tax the instrumentalities of a State or a subdivision thereof.

Mr. HULL: I do not undertake to express an opinion either way upon the power of Congress to impose such tax by virtue of the recent constitutional amendment. It does not necessarily arise in view of the provision in the bill.

50 Cong. Rec. 508 (1913).

APPENDIX E

REMARKS OF SENATOR THOMAS

After passage by the House of Representatives, Senator Thomas greeted a pending revenue bill with the following remarks:

> While constitutional questions have during the war became recondite, their intrusion upon novel and comprehensive schemes of legislation can not be prevented. Here they lie upon the very surface of the bill. The House report reveals and briefly disposes of them upon considerations of justice and equity. That is an easy method. If sound, we shall have no difficulty in removing restraints upon our legislative powers. We can relegate the Constitution to the limbo of things that were, and measure our authority by our discretion, should we care to retain that faculty. Personally, I am unable to reconcile my oath of office with this new standard of construction, although in the given instance it negatives the conclusion asserted.
>
> The pending bill is obnoxious to the Constitution in not less than three important particulars. I refer to the proposed taxation . . . of State, and municipal securities and salaries . . . .
>
> The bill also includes on [sic] gross incomes the "interest from the obligations of States and political subdivisions thereof issued after its passage," together with the compensation of State and municipal officers. These items have also been excluded either expressly or by judicial decision from previous income tax legislation. Of the unconstitutionality of this proposed imposition, I entertain no doubt whatever.

56 Cong. Rec. 10,628-29 (1918).

APPENDIX F

STATEMENT OF SENATOR BAKER

On June 28, 1968, President Johnson signed into law as Section 107 of the Revenue and Expenditure Control Act of 1968 a measure to eliminate the tax-exempt status of industrial development bonds. The amendment which I introduce is an attempt to correct the present distorted definition of "industrial development bonds," which is not limited to bonds for industrial development, but rather is so broad as to include bonds for many acknowledged and traditional state and local governmental functions.

Members of Congress who supported the taxation of "industrial development bonds" now realize that by means of the definition employed in the Act, they have gone much further than they intended. Chairman Wilbur Mills of the House Ways and Means Committee acknowledged this fact on the floor at the time of passage of the Act and invited the National Governors Conference and others to propose corrective legislation. Without such correction, the 90th Congress will have challenged the exemption of state and local governmental bonds issued for a host of acknowledged governmental functions wholly unrelated to the industrial development bond problem.

The amendment which I offer is basically a portion of a bill introduced by Congressman Mills in the House of Representatives and by Senator Curtis in the Senate after passage of the Revenue and Expenditure Control Act. A few technical refinements have been made to dispose of minor objections. This amendment has the support of the National Governors Conference; the National Association of Attorneys General; the National Association of State Auditors, Comptrollers and Treasurers; the Council of State Governments; the National League of Cities; the United States Conference of

Mayors; the Municipal Finance Officers Association; and the National Institute of Municipal Law Officers.

I recognize that this is a complex area and that hearings on this question would be desirable. In fact, I believe we are confronted with the present distorted definition because no hearings were held prior to the enactment of the Ribicoff Amendment. I believe that the definition which I offer is far superior to the present statutory language and that, at the very least, it will serve as a corrective measure until this question can be fully aired during the next legislative session.

The practical effect of the present definition is to include within that definition bonds for practically any state or local governmental purpose if the financed facility would have private occupants paying to use it. Thus, the enacted definition includes, among other, bonds for markets, nursing homes, piers, fairs, and recreational facilities.

It is true that the present act does not tax all of the bonds it labels "industrial development bonds." What the present act does is set up a list of approved purposes labeled "exceptions." Bonds for these purposes remain exempt and those for all other state and local governmental purposes are taxable when private occupants pay to use the financed facilities. Thus, the Congress purported to classify as good or bad all the legitimate functions of state and local government, rewarding good purposes with exemption and penalizing bad purposes with taxation. Among the bad purposes are such fundamental governmental functions as education and health care, which are totally unrelated to the development of new industrial plants.

The present list of enacted exceptions presents substantial difficulties. For example, as originally passed by the Senate, there was an exception for property "to provide entertainment (including sporting events) or recreational facilities for the general public." As enacted, this

was cut down to "sports facilities" with the result that an exemption is currently provided for bonds to finance a stadium built for rental to a professional baseball team shopping for a more lucrative franchise, but no exemption is provided for a public theater for lease to a company providing concerts and drama.

As another example, the exception in the present act for terminal facilities includes airports and piers for air and marine vehicles, but does not include terminals for land vehicles such as buses, trucks, or railroads.

Finally, facilities for education or health care are not among the listed exceptions in Section 103(c)(4).

This type of continuing regulation by selection of state and local governmental functions has no proper place in our federal system and accordingly should be abandoned.

The amendment which I introduce would provide a general redefinition of "industrial development bond" in accordance with the generally accepted meaning of the term. Section 1 requires that some private person who is not an "exempt person" must be the apparent "beneficial obligor" and that the bond be issued to finance "industrial property" or "independent wholesale or retail property." "Industrial property" would be limited to its natural meaning of factory-type structures and equipment. It would not include facilities in factories for the abatement of air or water pollution, waste disposal, or other health or safety functions. "Industrial wholesale or retail property" includes structures for shops as well as retail department stores and similar mercantile establishments. The definition of "exempt person" is retained from the present act and includes governmental units and educational, charitable, and other tax-exempt institutions.

The requirement of a private, taxable, "beneficial obligor" is critical. So long as the Congress does not propose to challenge the long-standing Constitutional rule of

the states' and local governments' immunity from taxation of their obligations, the *only* basis for taxing any bonds issued by state or local governments is that they are the issuers' obligations in name only, that the issuer is disassociated from the obligation and from the facility financed, and the investor considers the private user as the true obligor.

The attributes of such a disassociation, as set forth in the amendment are: (1) the putative private obligor will be using the property financed under lease or other contractual arrangement which requires him to pay all or most of the funds needed to meet debt service on the obligations, and (2) the putative private obligor and his contractual arrangement are identified in the bond agreement or in the offering prospectus, and his payments thereunder and/or the financed property are specifically pledged or mortgaged to secure the bonds.

I recognize that there has been some abuse in some local industrial development bond projects. This amendment would require the taxation of bonds for industrial development in cases of acknowledged abuse but would not include bonds issued for traditional state and local governmental functions. I strenuously object to any legislation which attempts to repeal outright the tax exemption on state and local bonds or to any legislation which penalizes or rewards the states by taxation or exemption, depending on whether the federal government approves or disapproves of the purpose for which the bond is issued. The method of classifying various bond issues as acceptable or unacceptable to the federal government is a dangerous development and an unwise precedent.

I do not believe that Congress should have, in a cavalier fashion and in the absence of hearings, revoked the tax-exempt status of industrial development bonds. At the very least, I believe this redefinition in accordance with the generally accepted meaning of the term should be adopted.

114 Cong. Rec. 30980 (October 11, 1968).

APPENDIX G

REMARKS OF REPRESENTATIVE DAN ROSTENKOWSKI

During the Congressional discussion on the Municipal Taxable Bond Alternative Act of 1976, Representative Dan Rostenkowski stated his reluctant opposition to such proposal:

> My opposition to this legislation is based not on the present structure of the bill but on what I conceive to be a potential development that would result from extensive use of the subsidized taxable bond option. Under present law, the use of tax-exempt bond financing by cities and states is strictly a local matter. Decisions to issue bonds as well as decisions on how and where to spend the resulting revenue are strictly local decisions made either by the voters directly or indirectly, through officials chosen to represent them.
>
> On the surface, H.R. 12774 does nothing to alter that situation, State and local governments will continue to issue bonds for projects they feel are necessary . . .
>
> My concern rests with the interest subsidy paid by the federal government. To the extent municipalities come to be reliant on the interest subsidy, they expose themselves to the risk of further federal control.
>
> Although this particular legislation offers the federal payment with no strings attached, it would be premature—and I believe somewhat naive—for local governments to believe that federal strings or conditions could not at some time in the future be attached—through either congressional legislation, bureaucratic regulation or judicial interpretation. It is not inconceivable to me to visualize the day

when the interest subsidy would be withheld if the purpose of the bond issue were either inconsistent with or in violation of some federal policy that was fashionable at that particular time . . .

In the end, cities that lose control of their finances, lose control of their destinies.

MUNICIPAL TAXABLE BOND ALTERNATIVE ACT OF 1976, Report from the Committee on Ways and Means to accompany H.R. 12774, 94th Cong., 2d session, Report No. 94-1016.

APPENDIX H

REMARKS OF SENATOR RUSSELL LONG

During the 1983 Senate discussions concerning the Social Security Commission recommendations and a proposal to include tax exempt income from municipal securities in determining whether or at what level social security payments were to be taxed, Senator Long criticized the proposal as an indirect attack on what he described as a constitutionally derived right of state sovereignty. Senator Long stated:

> We had this same issue before us on the TEFRA bill, and the Senate voted by a clear margin to strike out the proposal that would put the minimum tax on State and municipal bonds. It recognized the same principal which has been upheld by great Justices down through the years, including Justice Charles Evans Hughes, that we do not have the power to do that. And the Congress, Mr. President, has in the main denied the Internal Revenue Service the right to take the States to court to try to prove that they could tax these bonds under the Constitution. Congress has expressly put in the law up to this point that the income from these State and municipal bonds is not taxable, and that it is not our purpose to tax them. The Congress has also kept the faith that the sponsors of the constitutional amendment permitting the income tax made when they passed that amendment and assured the State legislatures that it did not tax these bonds, that it was not their intention to do that, and that they did not do that.
>
> Cong. Rec. S3730, 3735 (daily ed. Mar. 23, 1983).

The Social Security proposal was subsequently adopted after assurances by Senator Dole and others that the intent was not to "tax tax-exempt income", *id.* at S3736, but rather to avoid increased incentives for the buying

of tax exempt obligations, *id.* at S3737. It should be noted that Senator Moynihan inserted in the record a memorandum to the effect that such taxation would be constitutional, *Id.* at S3738.